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DIRECTORATE OF
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Intelligence Memorandum

Egypt: Recent Economic Performance And Immediate Prospects

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
July 1971

INTELLIGENCE MEMORANDUM

EGYPT: RECENT ECONOMIC PERFORMANCE AND IMMEDIATE PROSPECTS

Introduction

1. The 1967 war with Israel and its immediate aftermath reduced Egypt's economic base and hampered economic progress by diverting resources to defense-related objectives and by aggravating Egypt's balance-of-payments problems. Nonetheless, steady but limited economic growth has been registered in the last three years. This memorandum describes the progress achieved thus far and assesses the prospects for further gains in the next two years.

Discussion

The Prewar and Immediate Postwar Depression

2. When the Arab-Israeli War began in June 1967, Egypt's economy had been stagnating for two years following a five-year period of relatively rapid growth. By the end of fiscal year 1965, 1/ most accumulated foreign exchange reserves had been exhausted by large investments for economic development, a government-encouraged increase in consumption, and efforts to play an enhanced international role. Output in Egypt's import-dependent manufacturing sector had dropped, primarily because foreign exchange shortages had forced stringent rationing of imports. Investment had declined, leaving the construction industry functioning at part capacity. Meanwhile,

1. The Egyptian fiscal year ends on 30 June of the stated year.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

agricultural output also was stagnating, largely because Cairo was keeping farm prices unrealistically low 2/ and generally neglecting the farming sector.

3. The Six-Day War seriously exacerbated many of Egypt's economic problems. Occupation of Sinai, closure of the Suez Canal, and continuing hostilities in the canal area cost Egypt a substantial portion of its military equipment, some $400 million a year in foreign exchange, and assets that normally produced up to 7% of the nation's economic output.

4. The economic impact of war-related losses was cushioned by foreign aid. Before the end of the first postwar year, the USSR had replaced all lost military equipment at no immediate cost to Egypt, 3/ and Kuwait, Libya, and Saudi Arabia had come forward with sufficient monetary aid to offset a large portion of other foreign exchange losses. Thanks primarily to foreign assistance, the decline of gross domestic product (GDP) was held to 3% in fiscal year 1968, compared with fiscal year 1967.

Economy Recovery

5. Substantial economic progress has been made since the end of fiscal year 1968. According to national account data provided to the International Bank for Reconstruction and Development (IBRD), GDP grew about 4% in fiscal year 1969, and the IBRD estimates that growth proceeded at about this pace through fiscal year 1970. The growth rate was below the 5% to 6% per year projected earlier by the Egyptians, primarily because oil output did not increase as rapidly as expected.

6. The major factor in the recovery in fiscal year 1969 and later appears to have been an increase in defense-related demand that activated idle industrial resources. The steel complex at Helwan, once operating at less than half capacity, has been brought to capacity or near-capacity operation, and, with Soviet help, the Egyptians appear to have shifted a number of idle consumer goods plants to various kinds of defense-related activities. Construction of missile sites and other military installations apparently absorbed all the slack created in the construction industry by completion of the various phases of the Aswan High Dam.

7. Agriculture also revived. Good weather helped, and the Aswan High Dam, by making additional water available during the summer months,

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2. All farm produce in Egypt is sold either directly or through cooperatives to government marketing agencies. In the interests of urban consumer welfare and government profits, prices paid the farmers were kept low.

3. Partial payment probably will be required eventually.

introduced a new flexibility to the crop cycle. Farm prices were revised in 1969, raising incentives and checking the downward trend in private rural investment and slow drift from commercial to subsistence crops.

8. Rising exports and aid from Kuwait, Libya, and Saudi Arabia enabled Egypt to finance the import growth necessary for expansion. Borrowing from abroad, however, yielded almost no net capital inflow. Debt repayments have offset most new drawings since 1967, when debt rollover agreements were concluded with most major creditors.

9. On balance, favorable developments in commodity trade have more than made up for unfavorable events. Total annual export earnings have risen $200 million since fiscal year 1967. Trade setbacks have included a sharp drop in world rice prices, loss of the Sinai oilfields, destruction of the Suez fertilizer plant and oil refineries, and a drop in the price of crude oil from the Gulf of Suez caused by the longer hauls resulting from closure of the Suez Canal. Important among favorable developments have been an increase in world cotton prices, a bumper cotton crop in fiscal year 1970, growing success in selling manufactured consumer goods -- especially to bilateral trading partners 4/, and expanding crude oil output. Despite price discounting, earnings from crude oil increased 160% between fiscal year 1967 and fiscal year 1970 (see the table). The El Morgan oilfield, offshore in the Gulf of Suez, was the principal factor in the rise in oil exports. By the end of 1969, El Morgan production, which had begun just before the 1967 war, and output from a small new field at El Alamein in the Western Desert had more than offset the loss of Sinai output. By 1970 the petroleum balance of payments was in surplus for the first time in years.

10. Kuwait, Libya, and Saudi Arabia give Egypt $250 million annually in accordance with the 1967 Khartoum Agreement. Egypt also has received more than $250 million in ad hoc aid, primarily from Libya. Some $100 million of this was received in fiscal year 1970, when export expansion and Arab aid together raised inflows almost $400 million above the low of fiscal year 1968. Subsequently, however, the inflow of Arab aid beyond Khartoum assistance has declined sharply.

11. Egypt's modest postwar recovery has been achieved with relatively little investment; much of the growth was derived from increasing utilization of existing capacity with some change in product mix. In fiscal year 1968, state investment allocations were slashed to a ten-year low of about $475 million, compared with an average of about $700 million a year during fiscal years 1961-65. Arab aid facilitated a somewhat higher allocation in

4. Communist countries and certain less developed countries.

Egypt: Crude Petroleum Exports and Earnings, by Fiscal Year

Fiscal Year	Crude Oil Exports (Thousand Barrels per Day)	Export Earnings (Million US $)
1967	19	12.9
1968	12	5.6
1969	22	18.8
1970	72	33.8
	Percent Increase (1970 over 1967)	
	279	162

fiscal year 1969, and investment outlays subsequently stabilized at about 15% of gross national product.

Prospects

12. The peculiar set of circumstances that has fostered Egypt's recovery from economic depression will not likely persist. Egypt will find it difficult to maintain its recent growth rate through the next two years. Foreign exchange is becoming increasingly scarce despite the expansion of domestic energy sources, notably petroleum and electric power, and the continuing expansion of the Helwan steel complex and certain other capital goods plants. The potential for re-activating idle facilities has been pretty well exhausted; future expansion almost certainly will require a higher level of investment, with attendant increases in domestic and foreign exchange costs. Egypt remains dependent on imports for many capital goods, raw materials, and intermediate goods. The year-long ceasefire has sapped both the willingness of the populace to accept and the will of the government to enforce austerity measures that would prevent the dissipating of foreign exchange on consumption. Prospects for increases in foreign exchange receipts from exports, Arab aid, and borrowing are not bright.

13. Export earnings are expected to rise very little over the next two years and could in fact drop below the level that was achieved in fiscal year 1970 partly on the strength of an exceptional cotton crop. Output from the El Morgan oilfield appears to be leveling off, and production from

the onshore fields on the Gulf of Suez and from the El Alamein field is on the decline. A new oil discovery in western Egypt cannot be expected to contribute to exports for at least another 18 months. Egypt should, however, derive significant gains from recent increases in world oil prices.

14. A sizable net inflow of capital from foreign lenders over the next two years now seems unlikely. The Soviet Union has promised some $200 million in economic aid, but Egyptian drawings on Soviet economic credits probably will barely offset repayment of past borrowings. Western creditors have shown no inclination to relax the stringent requirements of existing debt rollover agreements. In current debt negotiations between the United States and Egypt, the United States is insisting on some net repayment. New IBRD credit has, in turn, been made dependent upon a successful conclusion of the lagging US-Egyptian negotiations. The only net credits so far offered by the West that can be drawn upon during the next two years are the multinational loans promised for construction of the SUMED oil pipeline to link the Gulf of Suez with the Mediterranean Sea.

15. Barring reopening of the Suez Canal, 5/ Khartoum aid is expected to continue. Supplemental assistance from Arab donors has fallen from the fiscal year 1970 peak, however, and is quite likely to disappear altogether. Since the Sadat regime came to power last fall, Libya – which has provided most of the ad hoc aid – has transferred only $56 million beyond its Khartoum commitment, and there have been no ad hoc transfers since Egypt began peace overtures to Israel. Moreover, Libya's Qadhafi appears to be disillusioned with aid as an instrument for inducing Egyptian adherence to his policies.

16. Despite shaky prospects for foreign exchange inflows and a growing need for foreign exchange for investment purposes, the Sadat government has relaxed restraints on consumption that had been imposed after the 1967 war to conserve foreign exchange for priority uses. Shortly after assuming power, Sadat distributed sizable bonuses and promoted large numbers of people. These and similar measures have led to rising personal spending, and upward trend in prices, and increased demand for consumer imports.

17. Continuation of the trend toward increased public and private consumption is suggested in the announced state spending plans for fiscal

5. Under the terms of the Khartoum agreement, Arab donors are obliged to continue annual subsidies only until "the effects of the aggression are removed," a stipulation normally construed to mean only until the canal is reopened. Since annual canal revenues initially could fall as much as $75 million below the level of Khartoum subsidies, continuation of aid at a reduced level may be considered necessary after the canal is open.

year 1972. The state is to spend $450 million more than the amount budgeted in fiscal year 1971. Defense-related spending is to rise $170 million above actual outlays of fiscal year 1971, with most of the increase to be spent on war-associated relief efforts and/or military pay. The government's civilian wage bill is to rise $147 million, the largest increase since the 1967 war.

18. How the Egyptian government plans to finance its increased expenditure is unclear. Last year's more modest budget was some $100 million in deficit. As no measures to increase domestic revenues have been announced, increased recourse to bank borrowing appears to be in the offing. With excess capacity already absorbed and prices on the rise, credit expansion undoubtedly will have an adverse effect on the balance of payments, tending to stimulate imports and retard exports.

19. Prospects for economic growth three years hence, however, seem much better. New oil discoveries probably will be producing by then, and the SUMED pipeline may be in operation, earning transit fees on foreign oil and reducing the cost of marketing Gulf of Suez crude oil. Given the steady transition to giant tankers by major oil shippers, the pipeline will be a viable facility even after the Suez Canal is reopened. Success in obtaining Western financing for the SUMED project suggests that the Sadat regime has earned the benefit of the doubt from Western lenders. Consequently, prospects may be favorable for more Western credits tied to specific projects. If Egypt should reopen the Suez Canal and regain Sinai, after an initial lag, the recovery and gradual restoration of economic assets -- oilfields and refineries, fertilizer plants, and the like -- would stimulate the nation's economic growth over a lengthy period, as would the additional funds for investment. Although completion of the Aswan High Dam is yielding no sharp increase in economic growth, it has made available electric generating capacity that can supply additional power-consuming facilities for years to come. However, the land reclamation program associated with the dam, which was to raise agricultural exports 30% over a decade, will fall far short of Egyptian hopes. It now is clear that much of the land that was to be irrigated is of very poor quality and cannot be made to produce economically.